



BUDGET & ECONOMIC MONITOR

Committee on the Budget • Majority Caucus
U.S. House of Representatives
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Volume 2, Number 2

9 November 2005

WHY REFORM ENTITLEMENTS – AND WHY NOW? THE DEFICIT REDUCTION ACT OF 2005

Introduction

Four months before Katrina struck, Congress had already committed to addressing the growing crisis of Federal entitlement spending: The budget resolution adopted in April (the conference report on H.Con.Res. 95) included the first bicameral effort in nearly a decade to restrain the unsustainable growth in these programs. The worst natural disaster in the Nation's history – and the substantial Federal resources needed to help its victims – simply brought the fiscal challenge into a sharper and more immediate focus.

The House reconciliation bill scheduled for a vote this week – the Deficit Reduction Act of 2005 – is intended to deal with both. The discussion below reviews the reasons for both its necessity, and its urgency.

The Need for Reconciliation

Congress had begun restraining annually appropriated (“discretionary”) spending by holding non-security appropriations for fiscal year 2005 to 1.4 percent above the prior-year levels. (The fiscal year ended on 30 September 2005.) As a followup, the fiscal year 2006 budget called for actually *reducing* these accounts.

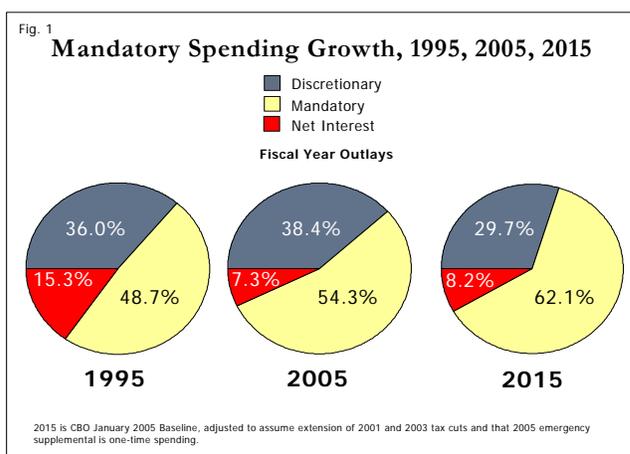
But the task of controlling overall spending could not be complete without addressing the largest part of the budget: Federal entitlements, which are not subject to annual appropriations.

Just 10 years ago, this spending (excluding interest) represented about 49 percent of the budget; today it is 54 percent; in just 10 years, it will exceed 62 percent (see Fig. 1). Further, overall entitlement spending is growing at a rate of nearly 6 percent per year. This relentless upward trend typically outpaces both the economy's growth and the long-

term average increase in Federal revenue. Hence the problem: this spending growth cannot be sustained without continuous cuts in other programs, ever-increasing taxes, or more debt financing.

Moreover, demographic and economic factors will worsen the problem in the future. Mounting medical costs, the forthcoming retirement of the baby-boom generation, and a *permanent* shift in the U.S. population – one that reduces the number of workers for each retiree even after the baby boomers are gone – will place unanswerable demands on government entitlement programs. They will crowd out other priorities and strain not only the Federal budget, but the Nation's economy as a whole.

For these reasons, the budget adopted in April called for \$34.7 billion worth of savings in mandatory spending programs over 5 years, through the process of budget “reconciliation.” (Reconciliation is an expedited, filibuster-proof procedure intended principally for controlling entitlement growth.) The amount represented only a fraction



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of the more than \$1 trillion in annual Federal entitlement spending; it would slow the growth of entitlements by less than one-tenth of 1 percentage point. But it was not insignificant.

First, the effects of entitlement program changes tend to accumulate and build over time. The budget resolution conference report called for \$1.5 billion of reconciled savings in fiscal year 2006; but that figure swelled to about \$35 billion over the 5-year period. This “wedge effect” tends to continue beyond the budget window.

Second, regardless of how large or small any particular reconciliation bill might be, controlling entitlements is always an incremental process. Since 1974, Congress has passed 19 reconciliation bills, 16 of which were enacted. Yet entitlement spending remains a problem. Long-term control of these programs is likely to require frequent reconciliation measures.

Third, in the process of restraining spending growth, these actions also tend to drive much-needed reform of entitlement programs – some of which have not been revised or updated in decades.

The Effect of Katrina

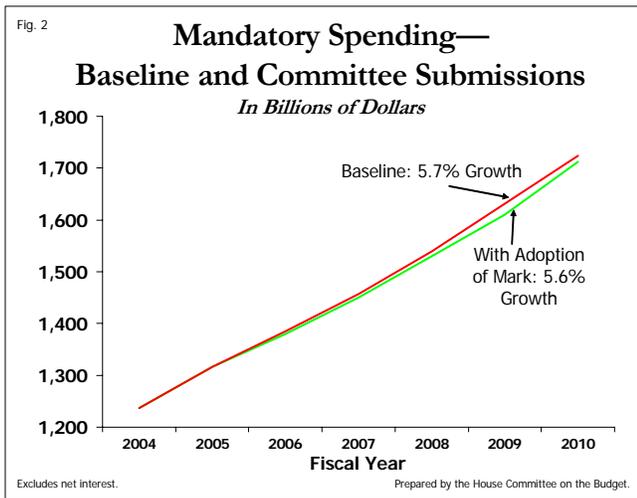
The demands on entitlements, though well known, develop and worsen gradually, and hence often fail to command the regular attention required to control them. Katrina changed that: It reinforced the *urgency* of spending control. In response, the House raised the ante for reconciliation: Committees were asked to increase their savings targets, relative to the budget resolution, and to begin offsetting the tens of billions of dollars that have been, or will be, spent for hurricane recovery. The new House reconciliation goal was \$50 billion in net mandatory savings – an amount reflected in the measure scheduled for the floor this week.

Again, this will achieve a small reduction in the growth of mandatory spending (see Fig. 2). But it gains importance for the following reasons: It starts the reform of government entitlements to make them, among other things, less costly in the long run; and it recognizes that hurricane recovery is important enough to warrant diverting resources to it that otherwise would have been spent elsewhere. It has become an exercise in the fundamental budgetary process of choosing priorities.

Conclusion

Major governing decisions often revolve around the congressional budget. The budget is, after all, the one legislative vehicle through which Congress looks at the whole picture, weighs priorities against one another, and sets its agenda. Reconciliation is a highly significant component of that process.

This year’s reconciliation process began as a modest effort to begin restraining entitlement growth. In the aftermath of hurricane Katrina, it took on the added role of realigning government priorities to account for the necessary recovery in the Gulf region. Neither issue can be fully resolved by a single bill; but both are entirely appropriate for consideration within the framework and procedures of the budget process.



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